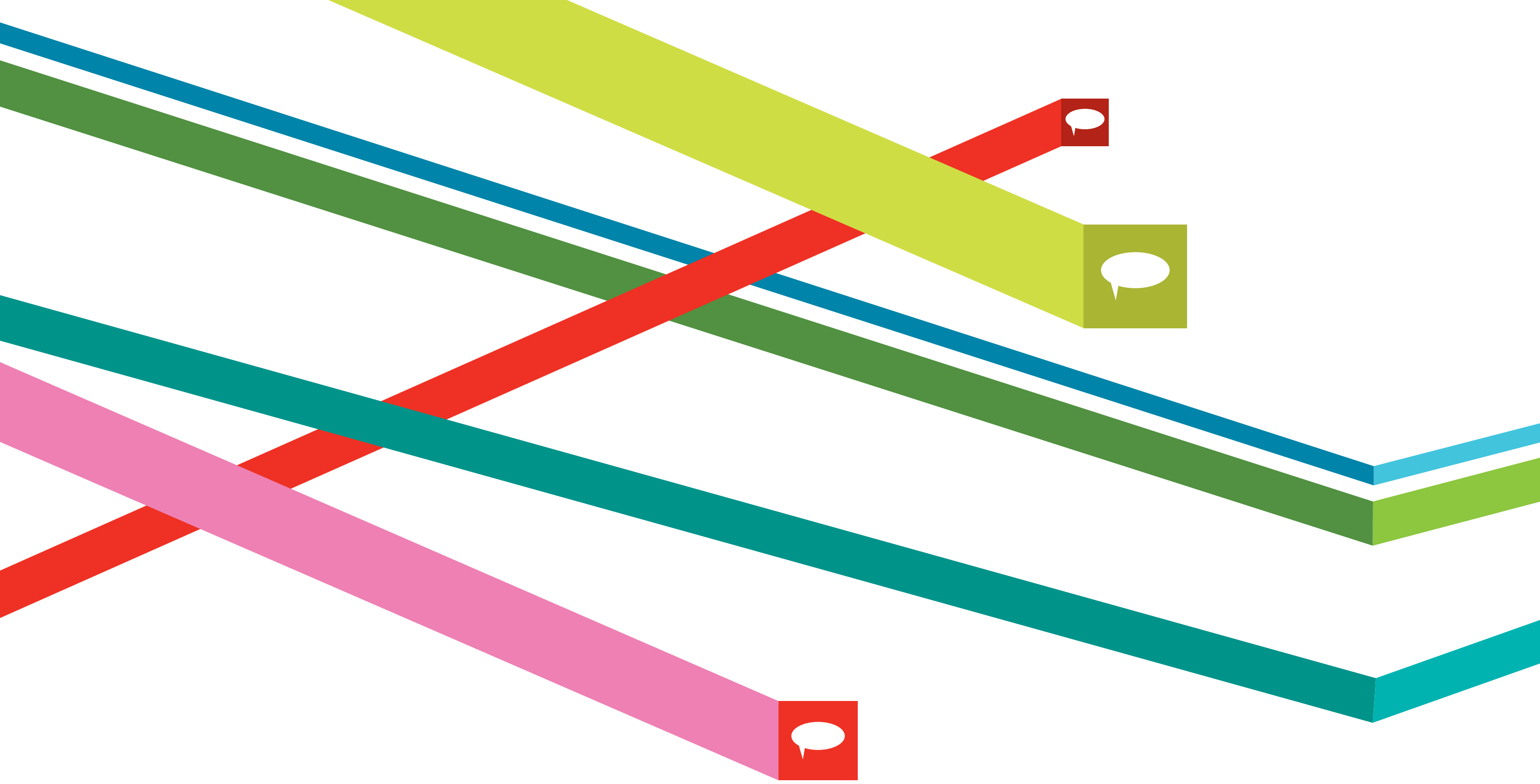
AARP

The Future of Social Security:
12 Proposals You Should Know About

You've Earned a Say[SM]



Strengthening Social Security

AARP's You've Earned a Say is working to make your voice heard about the future of Social Security. For more than a year, Washington has been talking behind closed doors about changes to Social Security as part of a budget deal with little discussion about how any changes would affect you and your family. You've spent your life paying into Social Security and you deserve to know what changes are being discussed so you can have your say.

That's why AARP is providing you with this booklet that contains balanced information about Social Security proposals that are being debated on Capitol Hill—the pros and cons—without the political jargon and spin. You deserve to know about the major proposals on the table so you can tell Washington what you think.

For more than 50 years, AARP has been fighting to protect and strengthen Social Security for today's seniors and future retirees. Now it's time to put Social Security on stable financial ground for the future so we can guarantee future generations get the benefits they've earned.

To join the conversation about the future of Social Security, go to **earnedasay.org**.

“I want my children and grandchildren’s future to be secure.”

The Future of Social Security:
12 Proposals on the Table in Washington

What are the pros and cons of options on the table in Washington?

You’ve paid into Social Security, and you deserve to know what changes are being proposed and how each might affect you and your family.

With more people living longer, Social Security faces increasing financial challenges. Estimates indicate the program will be able to pay full benefits for the next 20 years, but only 75 percent after that.

Here are summaries of 12 options being talked about in Washington. Each summary is accompanied by two opinions that AARP commissioned from experts whose views typically represent different sides of the issues. The calculations in these options are based on the 2011 Social Security Trustees’ report.

The experts:
David John of the Heritage Foundation.
Virginia Reno of the National Academy of Social Insurance.

The calculations in this booklet are based on 2011 data from the Social Security Trustees report.

Raise the Full Retirement Age

The age when a person becomes eligible to receive full Social Security retirement benefits (the full retirement age) has been increasing from age 65 on a schedule set by Congress in 1983. It has reached 66 and will gradually rise to 67 for those born in 1960 and later. Raising the full retirement age further is one option to help close Social Security's funding gap. The earliest age for claiming reduced benefits could remain at age 62, but the monthly benefit for those claiming early would be further reduced —about 6 to 8 percent for each year that the full retirement age increases.

One proposal would raise the full retirement age to 68. Starting in 2023, the age would increase by two months each year until it reached 68 in 2028. This is estimated to fill 18 percent of the funding gap. Another proposal would raise the full retirement age to 70. Starting in 2023, the age would increase by two months each year until it reached 70 in 2040. This is estimated to fill 44 percent of the funding gap.

Pro: People are living longer than ever before, and the full benefits age should be increased. Otherwise, recipients will spend an ever-greater amount of their lives living in retirement, which we simply cannot afford. When Social Security started in 1935, 65-year-old men expected to spend about 13 years in retirement. Soon, men will live about 20 years in retirement. Women in 1935 averaged 15 years in retirement. Soon, they will live almost 22 years. *(David John, Heritage Foundation)*

Con: Raising the full retirement age is a benefit cut no matter what age you begin taking benefits. The increase from 65 to 67 already in law cuts benefits by 13 percent. Low-earning workers have seen little or no gains in longevity. Raising the full retirement age for everyone simply because well-off Americans are living longer is a stealth benefit cut that is unnecessary and unjust. We can afford to improve and pay for Social Security without benefit cuts. *(Virginia Reno, National Academy of Social Insurance)*

"I've been paying into Social Security for years."

Longevity Indexing

If, as projected, Americans continue to live longer from one generation to the next, individuals will, on average, receive Social Security benefits for a longer period of time. The trend contributes to Social Security's funding gap, and one option to offset it is longevity indexing. Indexing would automatically modify Social Security to pay smaller monthly benefits as lifespans increase. Reducing the monthly payments could be accomplished either by increasing the age at which a person becomes eligible for full, unreduced retirement benefits (full retirement age) or by changing the benefit formula. Depending on the specific proposal, this is estimated to fill 20-26 percent of the funding gap. Indexing the full retirement age for longevity is estimated to increase it by one month every two years. Each year that the full retirement age increases there is about a 6 to 8 percent reduction in monthly benefits for any given age at which benefits are claimed.

Pro: Indexing the Social Security retirement age is a fair way to handle the fact that Americans are expected to live longer in the future. Assuming lifespans continue to increase, this method would increase Social Security's full benefits age by about one month every two years; if it started in 2025, the retirement age would increase from 67 to 68 by about 2049. This increase does not necessarily mean that someone would have to retire later. The alternative is a very slightly reduced monthly benefit. The individual retiree would have this information in plenty of time to decide which approach to take. *(David John, Heritage Foundation)*

Con: To index benefits for longevity would unfairly cut benefits for almost everyone. Low-earning workers and other disadvantaged groups have seen little or no gains in longevity. Cutting benefits for everyone just because well-off Americans are living longer would be profoundly unjust. Moreover, this change would violate the purpose of Social Security, which is to ensure basic economic security. Rent, utilities, groceries and medical care don't cost less just because some people are living longer. *(Virginia Reno, National Academy of Social Insurance)*

"The middle class need Social Security to survive their retirement years."

Recalculate the COLA

Social Security benefits generally keep up with inflation through a cost-of-living adjustment, or COLA. Since 1975, Social Security has based such adjustments on the consumer price index, which measures changes in the prices of consumer goods and services. One option to modify Social Security would be to use an alternative price index for calculating the COLA. Options include:

- Chained consumer price index: By applying a different formula to the same goods and services data, this index aims to account for ways consumers change their buying habits when prices change. Experts predict that the annual COLA would be on average 0.3 percentage points lower under this new formula. For example, if the current formula produced a 3.0 percent annual COLA, the chained consumer price index might yield a 2.7 percent COLA. The effect of a lower COLA would compound over time, reducing the benefit by 3 percent after 10 years and 8.5 percent after 30 years. Permanently reducing the size of the benefit adjustment every year is estimated to fill 23 percent of the gap.

- Elderly index: This method aims to reflect specific spending patterns of older Americans, in particular the greater amounts they spend on health care costs. Experts predict that the annual COLA would be on average 0.2 percentage points higher under this formula. For example, if the current formula would produce a 3.0 percent annual COLA, the elderly price index might yield a 3.2 percent COLA. In addition, the effect of a higher COLA would compound over time, increasing the benefit by 2 percent after 10 years and 6 percent after 30 years. Permanently increasing the size of the benefit adjustment every year is estimated to increase the funding gap by 16 percent.

Pro (chained consumer price index): The index used for the COLA must provide the most accurate estimate of inflation. The best index is the chained consumer price index, which both measures the inflation experienced by a larger part of the population than the current index and better represents the way that real people react to price changes in different types of goods and services. *(David John, Heritage Foundation)*

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Pro (elderly index): The current COLA doesn't keep up with the inflation that seniors face because they spend more than other Americans for out-of-pocket health care costs and those costs rise faster than average inflation. The chained consumer price index would make matters worse by reducing the COLA. A more accurate Social Security COLA would compensate for the higher inflation that seniors actually experience by using an elderly index. *(Virginia Reno, National Academy of Social Insurance)*

Increase the Payroll Tax Cap

The Social Security payroll tax currently applies to annual earnings up to $110,100. Any wages earned above $110,100 go untaxed for Social Security. This cap generally increases every year as the national average wage increases. Today, the cap covers about 84 percent of total earnings in the nation. Raising the cap to cover a higher percent of total earnings would help close Social Security's funding gap. How much depends on how high the cap is set and how quickly the cap would be raised to reach that level. One commonly mentioned goal would raise the cap to cover 90 percent of all earnings, which in 2012 would have meant a cap of about $215,000. This would mean any employee earning more than the current tax cap of $110,100 (as well as his or her employer) would have to pay more payroll taxes, up to about $6,500 per year for those earning $215,000 a year or more. Raising the cap to 90 percent is estimated to fill 36 percent of the funding gap.

Pro: Lifting the cap to cover 90 percent of all earnings is sensible and fair. Only 6 percent of workers earn more than the current cap of $110,100. It is fair for top earners to pay more into Social Security, and they would get a bit more in benefits. This change reflects the intent of Congress in 1977, when it set the cap to include 90 percent of earnings. Congress also provided for automatic adjustments for average wage growth so that the cap would continue to cover 90 percent. But with today's top earners enjoying much bigger gains than everyone else, the cap now covers only about 84 percent of all earnings. This proposal, together with other changes, could keep Social Security strong and pay for benefit improvements. *(Virginia Reno, National Academy of Social Insurance)*

Con: In general, increasing taxes is a serious mistake. It reduces the amount that Americans have to spend on their family's food, housing, clothes, education, etc. This bad idea would cause a hefty tax increase for middle-income taxpayers while not affecting the rich. It would especially hurt the self-employed and certain smaller business owners. To make matters worse, this tax increase delays Social Security's problems by only eight years. It does not fix them. *(David John, Heritage Foundation)*

Eliminate the Payroll Tax Cap

The Social Security payroll tax currently applies to annual earnings up to $110,100. Any wages earned above $110,100 go untaxed for Social Security. This cap generally increases every year with increases in the national average wage. Today, the cap covers about 84 percent of total earnings. Eliminating the cap so that all earnings would be subject to Social Security's payroll tax would help close the program's funding gap. If your income is under $110,100, you would see no change. If you make above that amount, you (as well as your employer) would pay the 6.2 percent payroll tax on your remaining wages. If all earnings were immediately subject to the Social Security tax, the new revenue is estimated to fill 86 percent of the funding gap.

Pro: Eliminating the tax cap would make Social Security's financing more fair. Only 6 percent of workers earn more than the current cap of $110,100. They would pay on all their earnings throughout the year just as everyone else does, and would get a modest increase in benefits. This change alone would just about eliminate Social Security's long-term financing gap. Combining this with other changes could wipe out the gap and pay for needed benefit improvements. *(Virginia Reno, National Academy of Social Insurance)*

Con: At first blush, the idea that people should pay Social Security taxes on all of their earnings seems both fair and attractive. However, this "solution" would cause huge Social Security checks for very high-income people. If millionaires pay Social Security taxes on all of their salary income, the maximum annual benefit payment could reach over $150,000 a year. This development would not bankrupt the program, but it would change its nature. Social Security was not intended to provide such large benefits. *(David John, Heritage Foundation)*

"Washington needs to open up its doors and listen."

Reduce Benefits for Higher Earners

Social Security benefit payments are based on the portion of a worker's earnings that was subject to Social Security payroll taxes. While higher lifetime earners receive higher payments than lower lifetime earners, their benefits replace a smaller share of their past earnings than do the benefits provided to lower earners. One option to help close Social Security's funding gap would be to reduce benefits for higher lifetime earners. This could be done by modifying Social Security's benefit formula in a number of ways, depending on who is classified as higher earners and how much their benefits are reduced. Most options use a sliding scale to reduce the benefits most for higher earners, make smaller changes for middle earners and make no benefit changes for lower earners. Options include:

- Reduce benefits for the highest-earning 25 percent. Gradually reducing benefits over time for the highest-earning 25 percent of individuals by a sliding scale up to a 15 percent benefit reduction for maximum earners is estimated to fill 7 percent of the funding gap.

- Reduce benefits for the highest-earning 50 percent. Gradually reducing benefits over time for the highest-earning 50 percent of individuals by a sliding scale up to a 28 percent benefit reduction for maximum earners is estimated to fill 31 percent of the funding gap.

Pro: In coming years, when Social Security won't have enough payroll tax money to pay full benefits to everyone, it seems only fair to pay full benefits to lower-wage workers and lower benefits to those who had higher earnings. Wealthier retirees have other ways, such as pensions and savings, to fund their retirements. They don't need full benefits. Everyone would still receive a benefit, but higher-earning retirees would receive less than they do now. *(David John, Heritage Foundation)*

Con: These proposals would actually cut benefits for middle-class workers making as little as $35,000 a year. They are not "high earners." Benefits are already modest. Retirees' health care costs are rising while other retirement resources—home equity, pensions, lifetime savings—are at risk or unavailable for too many Americans. Most seniors get most of their income from Social Security. Cuts are not the answer. We can afford to preserve Social Security's promised benefits. *(Virginia Reno, National Academy of Social Insurance)*

Benefit Improvements

Social Security provides benefits to retired workers and their families; to the spouses and dependents of workers who have died; and to workers who have become disabled and their families. Those benefits are too low for certain groups, according to some who argue that as part of any effort to strengthen Social Security, lawmakers should consider increasing benefits for more-vulnerable recipients. Some of the proposals to improve benefits are:

- Increased benefits for a surviving spouse
- Earnings credits for people who are not in the paid workforce because they are caring for a child or other family member
- A new minimum benefit that's guaranteed to keep low-paid workers with long careers above the poverty level

Each of these proposals would require other adjustments to benefits or revenue. Proposals to improve benefits for caregivers and low-wage workers have been estimated to increase the funding gap by 5-13 percent. There are no available estimates for proposals to improve benefits for surviving spouses.

Pro: Social Security has features of an ideal pension plan: It is portable from job to job, keeps up with inflation and lasts as long as you live. Most seniors rely on it for most of their income. Yet benefits are modest—$1,230 a month on average. We can afford to improve it. We could ensure that people who pay in at least 30 years will not be poor in retirement, give working parents' credit for care giving and improve benefits for survivors. We could also help any child of workers who die or become disabled by continuing benefits until age 22 if the child is in college or vocational school. *(Virginia Reno, National Academy of Social Insurance)*

Con: Although Social Security benefits for some groups are too low, they should only be improved as part of an overall reform. Otherwise, the added costs would only exhaust the trust fund faster. If that happens, benefits would be reduced for everyone. Instead, all of Social Security's benefits should be reviewed so that some can receive improved amounts, while ensuring Social Security will be able to pay every person appropriate benefits for decades to come. *(David John, Heritage Foundation)*

Increase the Payroll Tax Rate

Employees and employers each currently pay a 6.2 percent tax to Social Security on earnings up to $110,100. Self-employed workers pay both the employer and employee share for a total of 12.4 percent. One option to help close the Social Security funding gap would raise the payroll tax rate for all workers and employers. For instance, on a $50,000 annual salary, increasing the payroll tax to 6.45 percent would increase both the annual employee and employer contribution by $125 each. Changing it to 7.2 percent would increase the annual employee and employer contribution by $500 each. The rate increase could occur gradually or all at once. Increasing the payroll tax rate from 6.2 percent to 6.45 percent immediately is estimated to fill 22 percent of the funding gap. Increasing the payroll tax rate gradually over 20 years on employers and employees from 6.2 percent to 7.2 percent is estimated to fill 64 percent of the funding gap.

Pro: Gradually increasing the Social Security tax rate from 6.2 to 7.2 percent over 20 years makes good sense. Most Americans say they would rather pay more than see Social Security cut. This change—just 50 cents more a week for an average earner—would close just over half of the financing gap. Together with eliminating the earnings cap, it could pay for much-needed improvements and keep Social Security strong for the long-term. *(Virginia Reno, National Academy of Social Insurance)*

Con: Increasing Social Security's payroll tax rate is a bad idea that would increase everyone's taxes, no matter their income. Economists have known for decades that if the cost of employees gets too great, employers will start to replace them with machines or move to locations with lower taxes. Unfortunately, this does not hit all employees equally. Employers are most likely to replace younger workers and those with lower skill levels. *(David John, Heritage Foundation)*

"Social Security needs some changes but they must protect retirement security of future generations."

Tax All Salary Reduction Plans

Employees now pay Social Security and Medicare payroll taxes on their contributions to tax-preferred employer-sponsored retirement accounts, such as 401(k) plans. They don't, however, pay these payroll taxes on their contributions to some other types of benefit plans at work, like Flexible Spending Accounts. Collecting payroll taxes on contributions to all such benefit plans would increase the Social Security program's funds, as well as increase the earnings used to calculate the Social Security benefits of workers who have those benefit plans. If you contributed $2,000 to a Flexible Spending Account, you and your employer would pay the 6.2 percent payroll tax (or $124 each) on that money.Taxing these salary reduction plans for Social Security the same way we tax contributions to 401(k) plans is estimated to fill 10 percent of the funding gap.

Pro: Congress should complete a reform it launched in 1983 when it treated workers' contributions to 401(k) salary reduction plans as earnings that are taxed and counted toward Social Security benefits. Extending the same treatment to other such plans would be consistent, it would ensure workers that all of their earnings will count toward their future Social Security benefits, and it would reduce the Social Security funding gap. *(Virginia Reno, National Academy of Social Insurance)*

Con: This would be a case of robbing Peter to pay Paul. Changing the tax treatment of salary reduction plans would increase the cost of health care and other employee benefits because the tax savings help to offset the employer's cost of operating the plans. The result would be fewer employers that are willing to offer these types of benefits. Individual workers would either have to buy these benefits themselves or to do without. *(David John, Heritage Foundation)*

"I believe it's important to strengthen Social Security but with the current gridlock in Washington, I'm not sure it's possible."

Cover All Newly Hired State and Local Government Workers

About 25 percent of state and local government employees are not covered by Social Security. Rather, these workers are covered by retirement plans provided by state or local governments that have chosen not to participate in the Social Security program. Under one proposed change, Social Security would cover all newly hired state and local government workers. Those workers and their employers would each pay their share of Social Security payroll taxes, and the workers would receive Social Security benefits. Current state and local government workers would not be affected. This proposal is estimated to fill about 8 percent of Social Security's funding gap.

Pro: Social Security works best for everyone when it covers everyone. Workers gain seamless, portable life and disability insurance as well as basic retirement income protection. Any employer-provided pensions are then added to Social Security. Extending coverage to newly hired workers, as was done with federal employees in 1983 legislation, would ease the transition for the workers and jurisdictions that would be affected. *(Virginia Reno, National Academy of Social Insurance)*

Con: Making newly hired workers join Social Security would increase revenue now, but eventually the program would have to pay these workers benefits. That would make Social Security's financial problems even worse. In addition, certain already underfunded state and local government employee pension plans would see reduced contributions, and almost certainly need tax hikes to pay promised benefits. *(David John, Heritage Foundation)*

"When people work hard all their lives, there should be some peace of mind in retirement."

Increase Number of Years Used to Calculate Initial Benefits

Social Security retirement benefits are based on a worker's average earnings history. Average earnings are computed from a worker's highest 35 years of annual indexed earnings that were subject to Social Security payroll taxes. If a worker has fewer than 35 years of earnings, each year needed to reach 35 is assigned zero earnings. One option to help close the Social Security funding gap would increase the number of years of earnings used to calculate Social Security benefits from 35 to 38 or even 40. Because that method would typically include more years of lower earnings, the average earnings would decrease and benefits would be lower. Increasing the number of computation years to 38 is estimated to fill 13 percent of the solvency gap.

Pro: Increasing the number of years an individual must work to qualify for full Social Security benefits recognizes that most people are living and working longer than they did in the past. Today's method produces a skewed picture of an individual's full employment history and inaccurate Social Security benefits. Adding more years would encourage younger people to start working sooner, and the resulting small benefit changes would help to preserve Social Security for everyone. *(David John, Heritage Foundation)*

Con: This proposal would reduce benefits the most for people who need them most: women and lower-income, less-educated and minority retirees. It would reduce benefits not only for retired workers, but also for their dependents and survivors. Social Security benefits are modest and are already being cut as the retirement age goes up. We can afford to preserve, improve and pay for the Social Security benefits that today's workers are earning with their Social Security taxes. *(Virginia Reno, National Academy of Social Insurance)*

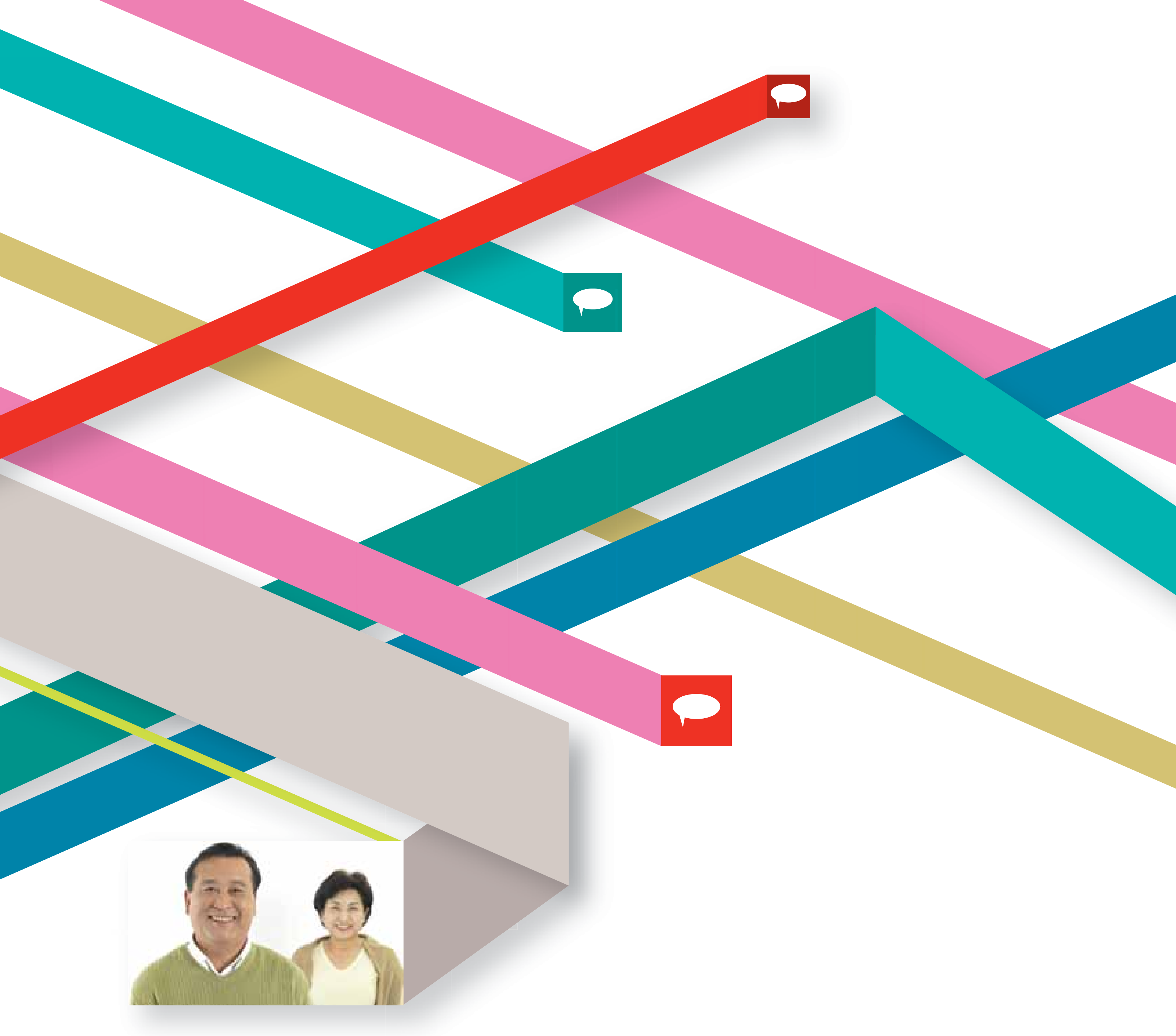
Begin Means-Testing Social Security Benefits

Social Security benefits have always been provided to anyone who has paid into the system and who meets the work and age requirements. That's regardless of other income—investment, pension, savings—the person receives in addition to Social Security benefits (although a portion of Social Security benefits is taxable if the total income exceeds a certain threshold). One option to help close Social Security's funding gap is to "means test." Means testing would reduce benefits for higher income recipients and could even eliminate benefits altogether for the highest-income households. Unlike the option to reduce benefits for higher earners, which uses a measure of career average earnings to reduce benefits, means testing would reduce benefits based on the full range of current income. Who would be affected and by how much depends on how the income thresholds are defined.

One version of means testing is estimated to fill about 11 percent of the funding gap.

Pro: In an era of scarce resources, Social Security can't continue to pay benefits to all retirees regardless of what other retirement income they have. Instead, the program should provide monthly benefits only to retirees who have less than a certain amount of non-Social Security annual income. Social Security would continue to be insurance against retirement poverty for everyone, but would focus its benefit payments on those who really need them. *(David John, Heritage Foundation)*

Con: Means testing would change Social Security from an earned right to welfare. It would penalize you if you saved or earned a pension because that income would reduce your Social Security. And it would cost more to administer. The government would have to routinely check your income and assets in order to adjust your benefit. Means testing would be a huge breach of faith with working Americans who earned their benefits by paying in over the years. *(Virginia Reno, National Academy of Social Insurance)*



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